Portugal's Economic Crisis: Overheating without Accelerating

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In April 2011, Portugal requested a bailout of €78 billion from the EU and IMF. Following the Greek crisis in 2009, successive Portuguese governments introduced numerous austerity programmes to reduce the country's budget deficit and public borrowing, and to send positive signals to the international community. But such measures were unable to alleviate market nervousness (Fishman 2011; Mody 2014; Brazys and Hardiman 2013). By 2010, risk premiums on Portuguese bonds hit record highs as credit ratings agencies downgraded the country's sovereign bond rating and Portugal had little choice but to seek help.

With all of the (much unwanted) attention Greece receives, the story of Portugal's economic crisis is perhaps less familiar. For many, Portugal's crisis is a simple case of contagion[1], while for others the country's 'chronic fiscal misbehaviour' and long standing productivity problems echo the Greek crisis.[2] Yet for many others, the Portuguese crisis is more complex and difficult to explain.[3] On the eve of its bailout, Paul Krugman suggested that the 'difficult' Portuguese macro story is harder to tell than those of Greece, Spain and Ireland:

> Greece was excessive government borrowing; Ireland and Spain, housing bubbles. Portugal, by contrast, wasn't all that bad fiscally — debt/GDP on the eve of the crisis roughly

[1] See Fishman 2011; Arghyrou and Kontonikas 2012; Kalbaska and Gątkowski 2012.
[2] For the Portuguese 'immaturity thesis' (Dooley 2014), see Pereira and Wemans 2012; Royo 2012; Soares 2012; OECD 2013; Blanchard 2007.
[3] Such as Rodrigues and Reis 2012; Krugman 2011; Serra 2014; Reis 2013.

> comparable to Germany. But it also didn't have surging house prices. There was a lot of private-sector borrowing, but it's not that easy to explain exactly why (Krugman 2011).

More puzzling still, while Greece and Ireland were booming post-euro membership, Portugal's economy stagnated. As a 2010 Deutsche Bank report put it, Portugal exhibited all of the signs of overheating, but without the growth. It quickly becomes clear that we are dealing with a very different crisis to that afflicting Greece. Portugal is not just out of sync with 'core Europe'; it is out of sync with the rest of the periphery (Lourtie 2011, 5).

In this chapter I shed some light on the 'difficult story' of Portugal's economic crisis over three chronological sections. In section one I show that the story of Portugal's difficulties begins with the fallout from its democratic revolution in 1974. The nascent Portuguese democracy sought to overcome the economic and political turmoil of the revolution (Maxwell 1995) by introducing a number of 'structural reforms', which were made, and legitimised with specific reference to joining the European Community (EC) by 1986. Section two shows how these structural reforms generated brand new patterns of economic growth during the 1990s. Yet behind this growth, the Portuguese economy had transformed into something quite fragile, into an economy driven by 'debt led domestic demand' growth (Lagoa et al. 2014). Section three explores how debt-led growth caused serious difficulties in the 2000s. I show that the stagnant growth during this period is a direct legacy of domestic and EU-driven reforms from the 1980s. I conclude by showing how this economic downturn ensured Portugal was particularly vulnerable in the context of the eurozone crisis.

Revolution and structural reform - Portugal 1974-1990s

The story of Portugal's economic crisis begins with a period of revolutionary turbulence. On the 25th April 1974, the 'Carnation Revolution' overthrew the forty year old dictatorship of Olivier Salazar's

Estado Novo.[4] The revolution began as a bloodless military coup but quickly turned into a full-scale revolution, leading to years of political uncertainty and revolutionary change. The revolutionary period (typically understood as from 1974-1979, see Morrison 1981) was characterised by 'political turmoil, social upheaval and military factionalism' (Maxwell 1995, 157). The institutional structure that was emerging during this time leaned towards the radical left, and included such policies as the constitutionally 'irreversible' nationalisations of banking and industry (Macedo 1990, 311). Yet, institutional construction during this period was a highly fluid and unstable process, and the socialist vision ultimately failed to take root. The authority of the state during the revolutionary period was frequently in question, with successive short lived and unstable governments 'barely having enough time to introduce their programs and nominate their ministers' (Maxwell 1995, 163; 170).

This political crisis was to be punctuated by severe economic instability. By the spring of 1975, an economic crisis emerged that had so far been postponed by the $2.8 billion of gold and foreign-currency reserves left behind by the Salazar dictatorship (Maxwell 1995, 139). Socialist Governments since 1974 had pursued large scale borrowing, expensive nationalisations and expansionary fiscal policies aimed at redistribution. These policies quickly dried up the *Estado Novo* reserves by as early as 1975. As a consequence, Portugal had accumulated massive debts, balance of payments deficits, and inflation was out of control (Macedo 1990, 324). 'Revolutionary' austerity and two IMF bailouts followed, creating strong electoral pressure for a new, non-socialist direction by the early 1980s (Maxwell 1995, 164).

This is where the origin story of Portugal's 2011 economic crisis begins. From the 1979 legislative election onwards, the centre-right *Social Democratic Party (PSD)* began to form and then lead successive governments (forming a grand coalition with the Socialist Party in 1983, and leading a minority government in 1985). This party, which was founded two weeks after the Carnation Revolution in May 1974, began to introduce a new institutional infrastructure which was to be

[4] Although Salazar had resigned in August 1968 due to health problems, and it was his successor Marcelo Caetano who was to be the last Prime Minister of the Estado Novo regime.

defined against the turmoil of the 1970s, and made possible through deepening European integration. In these years, the more radical elements of the 1974 revolutionary state were dismantled. The military dominated Council of the Revolution was abolished in 1982, and in the same year, a constitutional review weakened the powers of the President by restricting the ability of the office to veto legislation and dismiss parliament. Another major reform was reversing the supposedly constitutionally ‘irreversible’ nationalisations of banking and industry in a second Constitutional Review in 1989.

The major turning point came after the legislative election of October 6th 1985 when, under the leadership of Aníbal Cavaco Silva, a new minority government of the PSD was formed with the support of the PRD (Democratic Renewal Party), a new party founded in July of the same year. The economic situation began to improve shortly afterwards, bolstered by pre-accession EC aid (Magone 1997, 32). Accession to the EC in 1986 rapidly restored international confidence in the Portuguese market. Cavaco Silva and the PSD consolidated this popularity with a programme for economic and political stability in 1987, when they formed the Third Republic’s first majority government (Magone 1997, 32, 33). This government saw Portugal into the EC, and the accession coincided with the adoption of the Single European Act and progress towards the Single Market (Magone 1997, 34). It was these governments that implemented the structural reforms which were to characterise Portugal’s new economic trajectory in the following decades.

The popularity and success of the PSD structural reforms was helped by the fact that they appeared to be working well. By 1986, all indications suggested that Portugal was on the road to recovery. Rising growth, increasing domestic demand, falling unemployment and a positive balance of payments all served as evidence of the apparent success of PSD policies. It’s important to note that Portugal’s accession to the EC took place at precisely the moment the European project was undergoing its ‘re-launch’ with the Single European Act (SEA) (Teixeira 2012, 25). As such, the PSD reforms were closely linked to the introduction of various EC/EU reforms after 1986. These EU/PSD structural reforms were to have dramatic consequences for the Portuguese economy.

Structural reform and 'debt-led' growth: Portugal 1990-2000

By the mid-1990s, a mere twenty years after the revolution, Portugal's democracy and economy appeared stable, which was no mean feat considering the relatively recent turbulence of the late 1970s. Political and economic instabilities no longer constituted existential threats. In fact, the economy was actually growing, leading to a short but substantial boom in the 1990s. However, this economic growth was to prove precarious as it represented the growing importance of new economic sectors in Portugal, mainly the financial and non-tradable sectors.

Two important transformations to Portugal's economy during the 1990s are important to understand. First, as a result of structural reforms relating to banking and finance, driven by the PSD and the EU, private indebtedness rose dramatically during the 1990s, paving the way for a stagnant levels of economic growth in the early 2000s. Second, investment was redirected to the domestic, non-tradable sector of the economy, damaging the country's competitiveness and generating a particularly fragile pattern of growth for the country that had not existed before.

Structural reforms and the growth of private indebtedness

For Portugal, the 1990s were a decade of accelerated modernisation which were to have a clear transformative impact on the structure of its economy (Teixeira 2012, 25). It was during this decade that the Portuguese economy experienced the third fastest growth rate among the EU15 countries, falling behind only Ireland and Luxemburg, with GDP increasing at an average annual rate of 4.1% (Lagoa et al. 2014, 6; IMF 2002).[5] Unemployment fell to a record low of 4 percent in 2000, and

[5] Figures cover the period from 1986-2000.

inflation was brought down to just over 2 percent in 1999 (Royo 2012, 187; Cardoso 2005). Growth during the 1990s was particularly impressive, but the second half of the 1980s saw Portugal registering particularly high rates of growth (see figure 1). This early growth is largely attributable to the implementation of the European Single Market programme across Europe, but also to Portugal's accession to the EEC in 1986 which brought massive inflows of FDI and European structural funds along with it (Leao et al. 2013, 8).

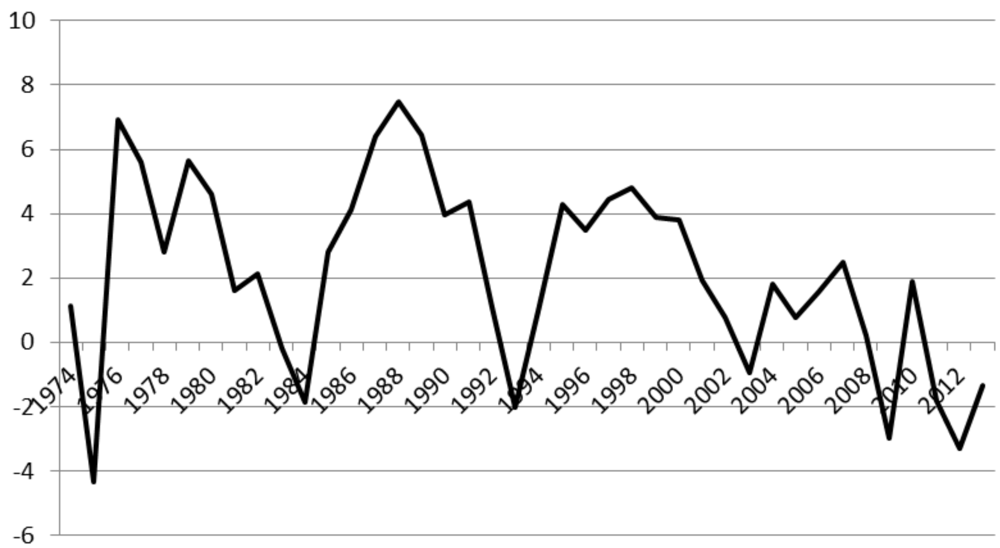

Figure 1: Percentage GDP Growth: Portugal

Source: World Bank - World Development Indicators Date here. Include in the References' list.

Portugal continued to grow up until the early 2000s, but in a damaging way. The structural reforms of the 1980s had particularly significant effects for banking and finance in the country. The Portuguese banking sector was rejuvenated and the restructuring of the financial sector produced a 'very competitive and innovative market highly suitable for absorbing the rapid increase in credit demand and for sustaining its dynamism' (European Commission Directorate-General for Economic and Financial Affairs 2004, 11; Banco de Portugal 2009, xxi). In anticipation of joining the Single

Market and EMU, reforms took place in terms of liberalisation of regulatory frameworks, privatisation and the freeing of international capital movements (Decressin and Mauro 1998, 5; Leao et al. 2013, 6).

Privatised, liberalised and deregulated banking and finance sectors represented a dramatic turning point for Portugal's economy. It is important to remember that in the wake of the 1974 revolution, the Portuguese banking system was characterised by pervasive public intervention and tight controls. All interest rates were fixed and there were even subsidised rates for eligible projects in agriculture, housing and exports. This all began to change in 1983 when the PSD helped form their first government of that decade. Key reforms were implemented that reversed state controls and the banking system was opened to private, foreign and domestic entry and authorised commercial banks to engage in medium-term operations (e.g. housing credit), blurring a previous distinction between commercial and investment banks. Following EC accession in 1986, there was a wide-ranging overhaul of the financial system (see Decressin and Mauro 1998, 7 for a detailed summary of these measures), propelled by various EU banking directives and other measures. Among the most important were the EU's Second Banking Directive of 1993, the EU's Capital Adequacy Directive (91/121/EEC), as well as Directives on the components of banks' capital (89/299/EEC), on the BIS solvency ratio (89/647/EEC) and on consolidated supervision (89/30/EEC) (Decressin and Mauro 1998, 7-9).

The upshot of many of these reforms was the raising of banks' opportunities to take on more risk, to provide new products, and to access new sources of financing. Interest rates were deregulated and credit ceilings were abolished among other measures. All restrictions in consumer credit were abolished in 1995 following the completion of the Single Market. Privatisations also played an important role in this changing landscape (see Decressin and Mauro 1998, 10 for a list of selloffs). By the 1990s the banking and financial systems in Portugal were completely transformed, and within a very short period (Honohan 1999; Dooley 2015).[6]

The consequence of all of this was that credit-fuelled consumer spending became a significant driver of economic growth during the 1990s (see table 1). During this decade, household savings decreased and household indebtedness tripled to just over 120 per cent of disposable income between 1994 and 2004, which as Cardoso (2005) notes was well above the euro area average of 80 per cent (2). Incredibly, private consumption was responsible for *70 per cent of GDP growth* in the period (Lagoa et al. 2014, 7).

Credit growth in Portugal during the 1990s was truly remarkable. It accelerated (in real terms) from close to 0 per cent in 1990 to more than 25 per cent in 1998. The result of this dramatic growth in credit was that by 2002, household debt approached 71 per cent of GDP in 2002 – up from just 15 per cent in 1990 (European Commission Directorate General for Economic and Financial Affairs 2004, 57; see also Lagoa et al. 2014, 17).

1995-2000				
GDP Growth	Contribution of:			
	Private Consumption	Public Consumption	Gross Fixed Capital Formation	Net Exports
3.6%	2.4%	0.7%	1.8%	-0.9%

Table 1: GDP growth and contributions of the main demand components in 1995-2000 (annual average, at 2005 prices)

Source: reproduced from Lagoa et al. (2014, 9).

[6] The discussion of this paragraph draws on the detailed account of Decressin and Mauro (1998, see especially pages 5-10).

All of this meant that household spending and household indebtedness rose dramatically during the 1990s. A 2004 European Commission report noted that the indebtedness of the household sector and non-financial sector more than doubled between 1995 and 2002 (European Commission Directorate General for Economic and Financial Affairs 2004, 12; Banco de Portugal 2009, xxi). Lagoa et al. similarly note that outstanding loans to households and non-financial firms increased from 50% to 93% of GDP, and that almost three fifths of this growth was directed at households, three quarters of which were mortgage loans (Lagoa et al. 2014, 10). None of this would have been possible without the structural reforms of the 1980s. In other words, the EU/PSD reforms are strongly implicated in the transformation of Portugal into a 'debt-led domestic demand' model of economic growth during the 1990s (Lagoa et al. 2014, 16). For Portugal, 'Europeanisation' meant debt led growth.

Damaging competitiveness

These reforms didn't just lead to an explosion in private debt. They also helped overheat particular sectors of the Portuguese economy in ways that severely damaged competitiveness. As a result of the newly liberalised banking and finance sectors, investment and capital inflows were attracted to inward-looking non-tradeable sectors, including construction, retail and privatised utilities. These sectors which were relatively more profitable than manufacturing as they were less exposed to foreign competition (Rodrigues and Reis 2012, 197). As Leão, et al. (2013, 12) note, the financial sector itself began to grow as a result of this capital inflow.

David Corkill writes how Portugal became gripped by 'construction fever' during the 1990s as a result of credit being directed to the sector (1999, 44-46). Lower interest rates and greater supply of credit created a situation where the construction industry was growing at four times the rate of the economy as a whole (Corkill 1999, 43). A 2013 IMF report notes how a liberalised financial sector combined with increased bank competition to direct a surge in capital flows into the non-tradable sector, which contributed to growing macroeconomic imbalances (IMF 2013, 8). The Portuguese economy, following EU membership, tended to favour domestic demand over exports – especially in sectors such as construction, real estate, and wholesale/retail trade – all sectors where, as the IMF notes, productivity was lagging (IMF 2013, 8).

The poor performance of the manufacturing sector in Portugal, concentrated mainly in 'traditional sectors' such as clothing, textiles and footwear, also contributed to the emergence of the debt-led model in the 1990s. Leão, et al. (2013, 18) argue that in the period from 1993-2007, it is clear that the newly liberalised and privatised banking system has given far more credit to construction, real estate and other non-tradable activities than to manufacturing, and that this difficulty for the latter in obtaining credit is partially due to the reality that banks assess manufacturing as a higher risk sector, 'exposed to competitive pressures from abroad' (Decressin and Mauro 1998). During the 1990s, but especially during the 2000s, there was clear competitive pressure from abroad, which threatened the Portuguese manufacturing-for-export sector. Because this sector suffered from low productivity and due to (warranted, as it turned out) fears about its future growth prospects, economic activity during the 1990s and 2000s redirected towards the non-tradable sector.

Over the course of the 1990s, the Portuguese economy was transformed into an economy mainly driven by domestic consumption, seeing the growth of the financial and non-tradable sectors, and the expansion of their activity. It was EU - as well as PSD-led reforms which created the conditions for a new type of economic growth. As such, Portugal's participation in the project of European integration since the 1980s set in motion a new form of economic growth. This new model of economic growth emerged directly as a result of Portugal's adjustment to the Single Market and its preparations for the euro. This new form of growth was about to hit a wall, and would lead Portugal directly to its 2011 bailout.

Economic Stagnation and crisis – Portugal in the 2000s

The fortunes of the Portuguese economy turned just before the 2000s when the country entered a prolonged period of stagnant economic growth. In stark contrast to the impressive and above average growth rates of the 1990s, between 2000 and 2013 economic growth stagnated to an average rate of 0.1% of GDP, the second lowest in the entire EU (only Italy was lower) (Lagoa et al. 2014, 6) (see figure 1). The causes of the economic downturn in the 2000s are crucial to understanding the difficulties that Portugal found itself in on the eve of its troika bailout in 2011. It was during this period that rising public and private debt coincided with dramatically low prospects of GDP growth. All of these factors led to falling investor confidence in Portugal after the 2008 crisis.

Portugal's downturn has its origins in the vigorous fuelling of credit led growth of the 1990s. Portugal was heavily indebted by 2000, to an extent that was not the case for Greece or Ireland at that stage (Lourtie et al. 2014). By the end of the 1990s consumers 're-assessed their income expectations amid high indebtedness and a rebound of interest rates, as well as a gloomier outlook with the Portuguese economy' leading to a dramatic fall in consumption (Cardoso 2005). Falling consumption during the 2000s is clearly evident when looking at the construction sector, in which, significantly, Portugal was the only European country to every single year from 2002 until 2011 (see Lourtie 2011, 6).

Similarly, because Portuguese companies tended to favour cheap debt over equity financing in the run up to euro membership, corporate indebtedness stunted investment growth in Portugal, which having peaked in 1997, gradually declined to eventually turn negative, in line with increasing leverage (IMF 2013, 9; Selassie 2012, 5–7). Interestingly, Portugal's experience from the mid-1980s to the 2010s is the reverse of the one experienced by Greece and Ireland. It already had private indebtedness levels that were too high by the turn of the century, whereas Greece and Ireland only really began to accelerate their levels of debt after the 2000s (Lagoa et al. 2014, 6).

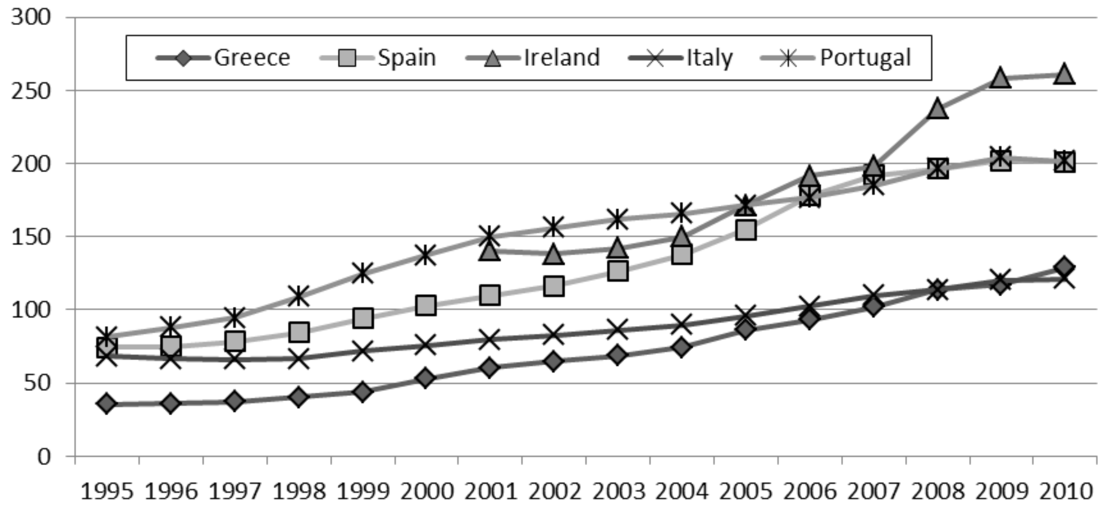

Figure 2: Private sector debt, consolidated - percentage of GDP

Source: Eurostat

This was to prove a difficulty for Portugal when, in response to signs of overheating in the Eurozone, the ECB raised its key interest rate from 0.25% in early 1999 to 4.5% in late 2000 (Lagoa et al. 2014, 12). This had a significant impact on domestic demand in Portugal – to an extent that it didn't in Greece and Ireland, where such high levels of private indebtedness did not exist around that time. Rising interest rates also had a negative impact on the Portuguese public deficit and debt levels, which became more expensive to service, leading to Portugal's breach of the Excessive Deficit Procedure (EDP) in 2001. As a result, the country was obliged to follow a pro-cyclical, contractionary fiscal policy, which further contributed to falling GDP (Lagoa et al. 2014, 12). As a consequence, economic policy during the 2000s was characterised by austerity, improving competitiveness and productivity (see Abreu 2006; Lourtie 2011, Royo 2012), which further dampened demand and economic growth. Unlike Spain, Ireland, and Greece, Portugal was bailed out after a decade of stagnation, not overheating.

Portugal's economic downturn in the 2000s has clear origins in the model of 'debt-led domestic demand growth' that emerged in the 1990s. As the European Commission Directorate-General for Economic and Financial Affairs reported, 'since 2001, private agents and public authorities alike have started to readjust their balance sheets, bringing spending more in line with incomes/revenues' (2004, 7). Portugal's economic success since the 1980s had been premised on the inflation of domestic demand. As this declined during the 2000s, the economy stagnated.

Declining export competitiveness: the rise of China and the CEECs

Adding insult to injury, Portugal's export sector encountered serious problems around the same time as the decline of its debt-led sector. Portugal's unemployment rate began to rise from 5.1 percent in 2000 to 9.2 per cent in 2009, and to 17.5 per cent in 2011. Aside from the steep rise after 2009, much of this unemployment can be attributed to declining export competitiveness and difficulties faced by the manufacturing sector. Between 2000 and 2007 Portugal lost jobs in manufacturing at an average annual rate of 2%, 'one of the fastest rates of deindustrialisation in the EU' (Lagoa et al. 2014, 13). Additionally, the increased indebtedness of non-financial corporations led to declining investment in Portuguese enterprises, because it may have increased the difficulty of their getting additional funding (Lagoa et al. 2014, 47).

It is important to understand that Portugal's exports have historically been concentrated in 'traditional sectors', especially in textiles, clothing and footwear. This industry has been contracting across Europe since the 1970s in the face of fierce competition from low-cost manufacturers in East Asia, North Africa, Eastern Europe and elsewhere (Corkill 1999, 158; Lains 2007). Portugal was threatened also, but due to its own low wages and integration into Europe, by 1999, textile and clothing was still a major industry, accounting for one third of manufacturing employment and some 20 per cent of the value of manufacturing output. It comprised some 30 per cent of total exports, 22 per cent of which were destined for the EU (Corkill 1999, 158, 159). Corkill, writing in 1999, estimated that one million people depended on the Textile and Clothing industry (159). The industry has typically been characterised by a large number of small and medium sized firms – 'only a little over 10 per cent of cotton textile plants have more than 500 workers' (Corkill 1999, 159). During the

1990s boom, the sector accumulated problems of low productivity and a lack of capital investment. This was to become more problematic in the 2000s.

Portugal's international competitiveness became threatened by China's entry into the WTO, the ending of the Multi-Fibre Arrangement in 2005[7], and the prospect of EU enlargements to Central and Eastern Europe (CEEC) (Serra 2014, 43). Due to this decline in international competitiveness, economic growth became more and more dependent on domestic demand (ibid 2014: 43). As a result of participation in the Single Market, but also to more general processes of trade liberalisation happening on a global level, Portugal became affected by its traditional productive sectors being exposed to 'wider and more aggressive foreign competition' (Serra 2014, 43). Portugal encountered difficulties in world trade markets, because of its specialisation in low-wage and low-value-added goods, which were especially hurt by competition from Central and Eastern Europe (CEEC) and China (Reis 2013, 148; NSRF 2013, 18; Lane 2013, 10; Mamede 2012; Sebastián Royo 2012, 205–213). The accession of the latter to the WTO in 2001 introduced a fierce competitor for Portuguese exports, one that, like Portugal, specialised in exploiting its low wages relative to richer EU countries (Reis 2013, 154). The ending of the Multi Fibre Arrangement in 2005 ended restrictions on the quantities of textiles and clothing that could be exported from developing economies to developed economies, further damaging Portuguese competitiveness, especially as so much of its exports went to Europe. It is important to note that the EU gave enthusiastic support to China's accession to the WTO (Sales Marques 2003, 33), to the dismay of Portugal (Amado Mendes 2010, 238). In an important respect, the EU's sponsoring of China further cemented the peripheral status of the beleaguered Portuguese economy.[8]

[7] The Multi-Fibre Arrangement was an international trade agreement on textile and clothing which imposed quotas on the amount that developing countries could export to developed countries.
[8] The EU adopted an active role as a broker and critical momentum was created by various EU proposals in the late 1990s which granted China transition periods for certain conditions, as well as the EU-China agreement of 2001 which helped lay important groundwork for formal accession (Mortensen 2009, 86).

Additionally, attempts at developing a more advanced export sector in medium-tech manufacturing (including some emblematic projects such as a large car plant – see European Commission Directorate-General for Economic and Financial Affairs 2004, 24) were stunted by the prospect of EU enlargement and competition from the CEECs. As such, in the second half of the 1990s, inflows of FDI into Portugal fell below EU average. In addition, Portugal's preparation for the euro led to the appreciation of Portugal's former currency, the escudo, during the 1990s, which further damaged export competitiveness, and promoted the redirection of economic activity to domestic demand. Portuguese exports of medium-to-high tech products like vehicles and electrical machines also lost market share over the 2000s, mainly to the CEECs, which have benefitted from a combination of lower wages and a more skilled labour force (Leão and Palacio-Vera 2011, 12). Anticipating the EU's eastern enlargement in 2004, a number of MNCs in automotive and related industries re-located their productive capacity from Portugal to the new member states (Mamede 2012). As a result, over the last decade the CEECs have attracted large flows of FDI into medium-to-high tech sectors, which had formerly headed towards southern Europe, including Portugal (Leão and Palacio-Vera 2011, 12).

The consequences for the Portuguese manufacturing sector were significant (Serra 2014, 43). Because the composition of Portuguese exports is almost twice as high in terms of 'low-tech' goods as compared to the rest of the eurozone countries, it seems obvious that their exports are likely to be more directly associated with competition from China and East Asia (Leão and Palacio-Vera 2011, 7). As Lourtie (2011, 5-6) notes, the textile sector represented 33 per cent of total Portuguese exports in 1990. It accounted for only 13 per cent in 2006. In addition, the market share of Portuguese exports in the EU15, the main destination for Portuguese exports (having accounted for 71% of total in 2008), declined by 33 percent between 2003 and 2009, mainly in favour of China and the CEECs. This led to more imports in the Portuguese market, and the skewing of the economic model towards services and non-tradables (Leão and Palacio-Vera 2011, 11).

This changing international economic environment contributed to consolidating the redirection of economic activity in Portugal. Economic growth became increasingly inward looking (Serra 2014, 43), contributing to the continued widening of Portugal's current account deficit. The competitiveness of China and other East Asian economies meant that the Portuguese economy was unable, under these conditions, to attract significant amounts of capital to its manufacturing and export sectors. Instead, investment tended to become redirected to non-tradable sectors. Portugal's economy transformed in precarious ways during the 1990s as a result of the EU/PSD structural reforms. Yet, it is also important to note the role of the EU in contributing to Portugal's competitiveness woes during the 2000s, not only through enlargement, but also through its enthusiastic sponsoring of China into the WTO.

Conclusion: Rethinking the Portuguese crisis

Portugal followed a unique path to crisis. In contrast to the experience of Ireland, Greece, and Spain, unemployment and public and private indebtedness increased as GDP growth stagnated. Portugal's public deficits and debt rose during membership of the euro, but they were nowhere close to Greece's levels at the time and in fact, its public debt did not exceed 60 per cent of GDP until 2007 (see figure 3) (Baer, Dias and Duarter 2012, 3). Germany's government debt exceeded 60 per cent this year also, and in fact, Portugal's public debt was lower than Germany's from 1996 until 2007. It was not until after the eruption of the eurozone crisis that Portugal's longer term structural fault lines began to mark it as a target for international financial market anxiety.

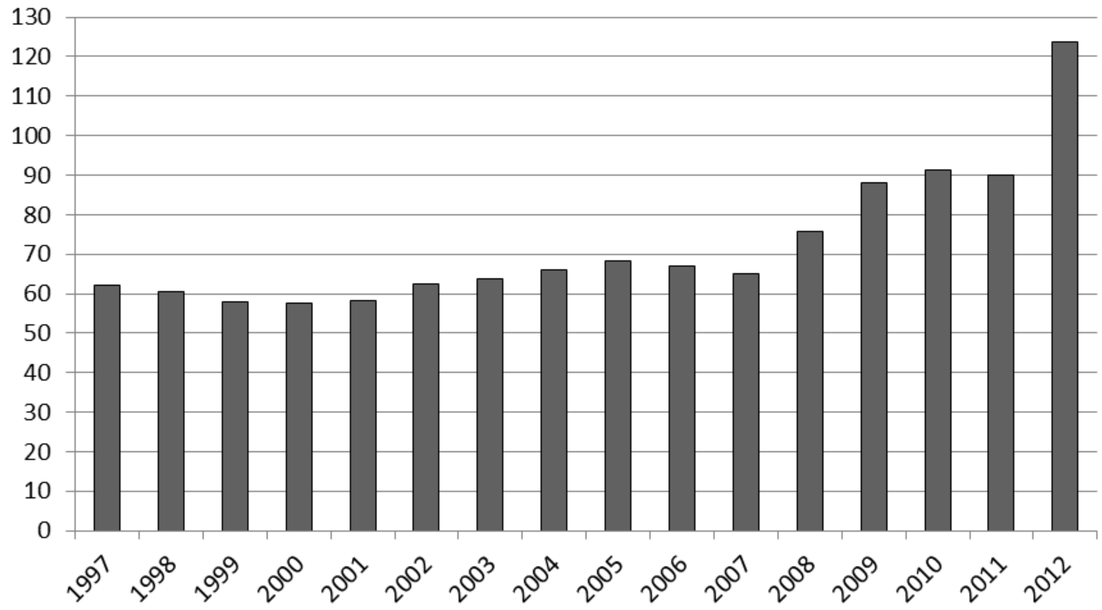

Figure 3: Portugal's central government debt, total (percentage of GDP) for Portugal, Annual, 1997-2012, Not Seasonally Adjusted

Source: World Bank, retrieved from FRED, Federal Reserve Bank of St. Louis

From 2009 the deficit increased dramatically as it did in most European economies during this time, to 9.3 per cent of GDP from 2.7 percent in 2008 (Lourtie 2011, 14). Portuguese governments responded to international market pressure following the Greek and Irish bailouts by introducing new austerity programmes (Lourtie 2011, 20). Nevertheless, as the eurozone continued to drift from crisis summit to crisis summit during 2010, Portuguese borrowing costs soared. As Lourtie notes, for Portugal in 2010 and 2011:

> Even the agreement reached late in the evening of Friday, 29 October, between the Portuguese government and the main opposition party (PSD) on the strong austerity 2011 budget, after very difficult and tense negotiations, had no positive effect on bond prices. It was clear by then that good news at national level could always be trumped by bad ones at European level (Lourtie 2011, 20).

Although Portugal was, to an important extent, a victim of contagion during this time, this contagion fed off the longer term structural vulnerabilities of the Portuguese economic trajectory.

This chapter has traced the emergence of these vulnerabilities since 1974, and argued that it was Portugal's transformation into a 'debt-led domestic demand' model of growth as a result of adapting to centre-right policies of the PSD, underpinned by European integration during the mid-1980s and 1990s that can account for its crisis. It has shown how the 'Europeanisation' of Portugal contributed in clear ways to the precarious divergence of its economy. Today, despite years of painful reforms and exiting its bailout agreement, Portugal's economy is still highly vulnerable. Its experience demonstrates nothing less than the complex *problematique* of a late developing peripheral European state attempting to catch up, via Europeanisation, with its Western European neighbours.

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